



November 2023

Supreme Court holds that rent receivables assigned to a lender would not be assets of the borrower and fall outside the scope of the NCLAT's Order freezing IL&FS's assets and security

In a recent decision in the case of *Infrastructure Leasing and Financial Services Ltd. v. HDFC Bank Ltd. and Another*¹, the Supreme Court of India ("Supreme Court") has held that the rents receivable by a borrower which was assigned to a lender of a lease rental discounting facility would not be treated as an asset of the borrower, and thus fall outside the purview of the asset and security freeze order of the National Company Law Appellate Tribunal ("NCLAT").

Brief Facts

1. Housing Development Finance Corporation Limited (now amalgamated with HDFC Bank Limited) ("HDFC/Lender") provided a credit facility of INR 400,00,00,000 (Indian Rupees four hundred crores) to Infrastructure Leasing and Financial Services Ltd. ("IL&FS/Borrower") ("Facility") pursuant to a master facility agreement ("MFA") in 2018. In connection with the Facility a separate escrow account was established with HDFC Bank ("Escrow Bank") for depositing the rents receivable by IL&FS.
2. In addition to the MFA, the parties had also signed an assignment agreement ("AA") which stated that the authorised debt owed by IL&FS to HDFC under the terms of the Facility would be paid back from the gross income and revenue from various business centre services/ lease/leave and license agreements ("Rental Agreements"). The AA assigned and pledged a sufficient portion of the rent receivable by IL&FS under the Rental Agreements in favour of the HDFC as the assignee had to pay the principal and interest payable by IL&FS to HDFC under the Facility.
3. Thereafter, the National Company Law Tribunal, Mumbai ("NCLT") *vide* the order dated October 1, 2018, in a petition filed by the Union of India ("UOI") under Sections 241 and 242 of the Companies Act, 2013, ordered to supersede the existing board of directors of IL&FS. However, the NCLT declined to issue the moratorium sought by UOI in respect of IL&FS on the same lines as under Section 14 of the Insolvency and Bankruptcy Code, 2016.
4. The UOI appealed before the NCLAT, the NCLT's decision to refuse moratorium regarding IL&FS. The NCLAT, *vide* its order dated October 15, 2018, declaring moratorium upon IL&FS and its 348 (three hundred and forty eight) group companies, and stayed "any action to foreclose, recover or enforce any security interest created over the assets of IL&FS and its group companies." ("NCLAT Order").

¹ 2023 SCC OnLine SC 1371

5. After the NCLAT Order, on the instructions of HDFC, the Escrow Bank continued to transfer monthly amounts from the escrow account to HDFC's account.

IL&FS alleged that such transfer of funds was in violation of the NCLAT Order, and hence, should be reversed. On the other hand, HDFC asserted its ownership over these funds based on the AA, stating that the rents receivable by IL&FS were assigned in favour of HDFC and ceased to be an asset of IL&FS.

6. The NCLAT *vide* the order dated May 13, 2022, ("**Impugned Order**") held that so far as the part of the rent receivables deposited in the escrow account sufficient to meet the principal and interest payable by IL&FS to HDFC are concerned, such rent receivables were assigned by IL&FS to HDFC. Hence, no proprietary interest continued with IL&FS in such part of the rent receivables, and it could not exercise any right over such part of the escrow account.
7. Aggrieved by Impugned Order, IL&FS preferred an appeal before the Supreme Court under Section 432 of the Companies Act, 2013.

Decision of the Supreme Court

1. The Supreme Court upheld the Impugned Order and confirmed that the documents executed by IL&FS constituted an assignment and were not subject to the NCLAT Order.
2. The Supreme Court, *inter alia*, held that:
 - a) Although a reading of the MFA would lead one to infer that the rents receivable by IL&FS form the security for advance extended to it by HDFC, the MFA cannot be read in isolation as it itself adverts to other documents involved in the transaction. The AA clearly provides that rents receivable by IL&FS stood unconditionally assigned to HDFC. The references of "security" and "pledge" at various places in the agreements did not undermine the parties' intent to absolutely assign the rents receivable. Therefore, IL&FS's contention that there was no assignment but only creation of security interest was rejected.
 - b) A lease rental discounting ("**LRD**") facility is a term loan facility under which a lender extends credit facilities to the owner of a commercial property. In such agreements, a substantial portion or the entire rent or receivables due to such owner is assigned to the lender. The primary purpose is to ensure that the borrower's liabilities are automatically discharged from the rental proceeds payable in connection with the property. Although the documents executed by IL&FS did not label the transaction as an LRD agreement, it is the nature and substance of the transaction which is determinative and in effect indicated that the transaction was an LRD arrangement. An LRD loan transaction involves a condition that a substantial portion or the entire rent or receivables are sold or assigned absolutely. The court relied on the provisions of the AA which set aside all receivables in favour of the assignee i.e., the lender bank. A power of attorney also appointed HDFC as the duly constituted attorney of IL&FS which authorized HDFC to appropriate proceeds received i.e., the rent receivables, towards discharge of their facility.
 - c) The Supreme Court relied on the Transfer of Property Act, 1882 ("**TPA**") in relation to actionable claims and various judicial decisions to conclude that rent receivables are actionable claims which are transferrable under the TPA. Accordingly, the future rents payable by IL&FS' tenants, lessees and licensees to IL&FS are unsecured debts which stood transferred to HDFC under the AA.

Conclusion

This ruling sets a significant precedent of a lender entering into an assignment agreement in connection with a secured lease rental discounting facility which was also secured against the commercial property and rent receivables from the property being treated as being ring fenced from other creditors as an outright assignment of actionable claims instead of a mere security interest. While in a few decisions courts have acknowledged the concept of equitable

assignment, assignment by way of security in favour of lenders and the legal impact of such an assignment had not been tested before a court.

This judgment could also be utilised by lenders who have executed assignment deeds as part of their security arrangement to claim insolvency remoteness in case of a corporate insolvency resolution process to bypass the statutory moratorium under the IBC.

Based on the judgments, it may be advisable for lenders who are relying primarily on cashflow security to also assign such receivables. While the issue of stamp duty has not been expressly dealt with by the court, it needs to be analysed whether such an assignment would also be treated as an assignment of debt which has beneficial stamp duty caps in many states for such assignments and not a conveyance of moveable properties which are stamped at *ad valorem* rates in most states.

Finance Practice

JSA has a widely recognised market leading banking & finance practice in India. Our practice is partner led and is committed to providing quality professional service combining domain knowledge with a constructive, consistent, comprehensive and commercial approach to issues. Clients trust our banking lawyers to take a practical and business-oriented approach to achieving their objectives. Our lawyers have a clear understanding of the expectations and requirements of both sides to a financing transaction and provide tailored advice to each client's needs. The practice is especially praised for its accessibility and responsiveness and its ability to work well with international firms and clients. We represent a variety of clients including domestic and global banks, non-banking finance companies, institutional lenders, multi-lateral, developmental finance and export credit institutions, asset managers, funds, arrangers and corporate borrowers in different sectors on a wide range of financing transactions.

Our full spectrum of services includes advising clients on corporate debt transactions (including term and working capital debt), acquisition finance, structured finance, project finance, asset finance, real estate finance, trade finance, securitisation, debt capital markets and restructuring and insolvency assignments.

Our practice has been consistently ranked in the top-tier for several years, and several of our partners are regarded highly, by international publications such as Chambers and Partners, IFLR, Asia Law, Legal 500, Asia Legal Business, IBLJ and Leaders League.

This Prism has been prepared by:



Dheeraj Nair
Partner



Tirthankar Datta
Partner











Angad Baxi
Senior Associate



Malika Tiwari
Associate



Vedika Gandhi
Associate

| | | |
|---|--|---|
|  |  |  |
| <p>17 Practices and 24 Ranked Lawyers</p> | <p>16 Practices and 11 Ranked Lawyers</p> | <p>19 Practices and 19 Ranked Lawyers</p> |
|  |  |  |
| <p>11 Practices and 39 Ranked Partners IFLR1000 APAC Rankings 2022</p> <p>-----</p> <p>Banking & Finance Team of the Year</p> <p>-----</p> <p>Fintech Team of the Year</p> <p>-----</p> <p>Restructuring & Insolvency Team of the Year</p> | <p>Among Top 7 Best Overall Law Firms in India and 9 Ranked Practices</p> <p>-----</p> <p>11 winning Deals in IBLJ Deals of the Year</p> <p>-----</p> <p>10 A List Lawyers in IBLJ Top 100 Lawyer List</p> | <p>Banking & Financial Services Law Firm of the Year 2022</p> <p>-----</p> <p>Dispute Resolution Law Firm of the Year 2022</p> <p>-----</p> <p>Equity Market Deal of the Year (Premium) 2022</p> <p>-----</p> <p>Energy Law Firm of the Year 2021</p> |
|  |  | |
| <p>7 Practices and 2 Ranked Lawyers</p> | <p>Ranked #1 The Vahura Best Law Firms to Work Report, 2022</p> <p>-----</p> <p>Top 10 Best Law Firms for Women in 2022</p> | |

For more details, please contact km@jsalaw.com

www.jsalaw.com



Ahmedabad | Bengaluru | Chennai | Gurugram | Hyderabad | Mumbai | New Delhi

This prism is not an advertisement or any form of solicitation and should not be construed as such. This prism has been prepared for general information purposes only. Nothing in this prism constitutes professional advice or a legal opinion. You should obtain appropriate professional advice before making any business, legal or other decisions. JSA and the authors of this prism disclaim all and any liability to any person who takes any decision based on this publication.